VZCZCXRO4389
PP RUEHCHI RUEHCN RUEHDT RUEHGH RUEHHM RUEHVC
DE RUEHHK #1829/01 2681120
ZNY CCCCC ZZH
P 251120Z SEP 09
FM AMCONSUL HONG KONG
TO RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEHC/SECSTATE WASHDC PRIORITY 8629
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHOO/CHINA POSTS COLLECTIVE

C O N F I D E N T I A L SECTION 01 OF 03 HONG KONG 001829

SIPDIS
SENSITIVE

STATE FOR EAP/CM AND EEB/IFD/OMA, TREASURY FOR OASIA,
BEIJING FOR DOLLAR

E.O. 12958: DECL: 09/25/2034
TAGS: EFIN ECON HK CH
SUBJECT: HONG KONG ANALYSTS CREDIT CHINESE STIMULUS FOR
ASIA'S RECOVERY

Classified By: Economic and Political Chief Martin Murphy, Reason 1.4 b
/d

¶1. (C) Summary: Hong Kong economic analysts give China full credit for Asia's rebounding economies. The region's financial systems were generally well capitalized and less exposed to toxic assets, making the rebound that much quicker, but with the exception of China, national fiscal stimulus packages were ineffective at best. Analysts believe we are now in the midst of a cyclical increase that should extend through 2010, as inventories are rebuilt and confidence returns to the region. Massive lending by Chinese banks is certain to lead to a rash of non-performing loans in 2012-13, but analysts believe Chinese leaders see this as a necessary cost and differ on just how big a threat these NPLs will be. End Summary

¶2. (C) Comment: Locally-based analysts are strongly optimistic about Asian, and particularly Chinese, economic prospects over the next several years. They see little risk to China's rapid loan growth and credit the speed of China's stimulus package announcement with boosting confidence across the region. While long-term structural problems haven't disappeared and no one is suggesting China will replace U.S. demand or economic leadership, observers in Hong Kong believe China has played the crisis just right so far. End Comment

¶3. (U) JP Morgan's Head of China Research Qian Wang, Royal Bank of Scotland (RBS) Economist Ben Simpfendorfer, Standard Chartered Regional Economist Kelvin Lau, HSBC Regional Foreign Exchange Strategist Daniel Hui, UBS Chief Asia Economist Duncan Woolridge, Hong Kong Monetary Authority (HKMA) Head of Research Lillian Cheung, and Credit Suisse Managing Director Vincent Chan shared their views on Asian governments policy responses to the financial turmoil of the past year and prospects for future growth in the region with Consulate Economic officers September 21-22.

## Recovery Made in China

¶4. (C) Hong Kong analysts agreed that Asian economies are emerging from the global slowdown and China deserves all the credit for Asia's relatively rapid recovery. The crumpling of U.S. and European demand for Asian exports, coupled with the lack of access to credit following the collapse of Lehman Bros. hit regional economies hard. Hong Kong saw trade volumes drop 20-30 percent, other regional economies saw similar downturns. Yet the relative soundness of Asian financial systems and their limited exposure to toxic assets is allowing a rapid rebound, said HKMA's Cheung. RBS, Simpfendorfer praised China's response as quick and credible, essential to boost confidence in China and the region.

¶5. (C) Analysts differ, however, over which part of the Chinese response deserves the most credit for the improved sentiment in the region. JP Morgan's Wang noted that China's fiscal stimulus package benefited from a large number of "shovel-ready" projects already on municipal and provincial drawing-boards. Quickly getting those projects approved and people working was crucial to restoring confidence. UBS's Woolridge disagreed, pointing to the unprecedented level of loan growth in the first half of 2009 as the key driver of recovery in China and the region. Credit Suisse's Chan suggested there was little difference between China's fiscal and monetary responses to the global financial crisis. High loan growth is tied directly and indirectly to local government borrowing to fund infrastructure development and other fiscal stimulus programs, said Chan. With exports still far below 2008 levels and domestic consumption unable to fill the gap, fixed asset investment driven by government borrowing is driving the Chinese economy.

=====================================
Government Spending Can't Last Forever
=====================================

¶6. (C) Whether they call it fiscal stimulus, loose monetary policy or some combination of the two, analysts believe that Chinese government-backed spending, particularly fixed asset investment, will continue to drive Chinese economic growth over the next several quarters. Local governments are enthusiastic supporters of this policy, while the Central government is starting to worry, said Chan. Government spending measures help now, but will become increasingly less



effective over time, warned Standard Chartered's Lau. Exports will increase in the near term as restocking takes place, but are likely to fall back again later in 2010 as U.S. demand remains low. Chan said most Chinese technocrats believe over-reliance on exports will squeeze Chinese growth prospects, but that the shift to increased domestic consumption will be a long process.

¶7. (C) The problem with the Chinese stimulus package, said Simpfendorfer, is that it is too narrow. China's economy needs structural reforms to open new sectors. Chinese manufacturing is now a mature sector with less obvious opportunities for rapid growth, he said. Exports to the rest of Asia may increase, but can't compensate for lower Western demand. Instead, China needs to open up the services sector, including logistics and marketing, and improve contract and intellectual property laws. Infrastructure development without structural reforms will not have broad-based economic benefits, he argued.

===========================================
Regional Economies Stimulus Depends on China
===========================================

¶8. (C) Fiscal stimulus programs in other parts of the region were uniformly dismissed by Hong Kong-based analysts as ineffective at best and harmful in some cases. Taiwan's voucher program to increase domestic consumption was targeted too widely and merely served to substitute for spending that would have taken place in any case, said Wang. It achieved nothing but widening the hole in the government's budget, she said. Hong Kong,s waivers, rebates and loan guarantees helped cushion the economic blow for low income residents and Small and Medium Enterprises (SMEs), but domestic consumption is still weak and infrastructure plans still haven't gotten off the ground, said Lau. Simpfendorfer agreed, noting that infrastructure projects in non-command economies take too long and most Asian tax systems do nothing to facilitate consumption. Stimulus programs in many regional economies were "worth less than nothing," he said.

¶9. (C) The Chinese stimulus is boosting demand for

commodities from Southeast Asia, components from Taiwan and Korea, and demand for services from Hong Kong, said Lau. UBS's Woolridge believes Asian manufacturers are finally beginning to benefit from record low inventory levels, as orders are finally beginning to pick up. Increasing production requires additional labor, and consumer confidence is rising as unemployment falls. He expects the recovery in Asia will gain steam over the next several quarters. However, massive Chinese loan growth has already created asset bubbles in housing and equities. In Hong Kong, RMB liquidity and international investors eager to tap into Chinese growth opportunities are fueling rising asset prices. HKMA's Cheung said that with global credit markets still relatively clogged, Hong Kong,s liquid markets and 100% deposit guarantee are attracting significant hot money flows that are boosting local property and stock markets. In the near term, this is creating a virtuous cycle of increasing wealth and confidence, she said.

=======================
NPLs Tomorrow's Problem
=======================

¶10. (C) Analysts agree that rapidly expanding loan growth in the first half of 2009 has fueled the regions, recovery, but differ on whether inevitable increases in non-performing loans are worrying. Woolridge acknowledged that NPLs and opportunities for corruption will increase, but argued that it is easier for Chinese policymakers to flood the system with liquidity to boost growth now and clean up NPLs later than to face a serious economic slowdown. HSBC's Hui echoed that view, noting that policymakers should be worried, but are more concerned about maintaining growth and are willing to "kick the (NPL) can down the road." Chan noted that local government debt as a percentage of GDP will increase from 5 percent in 2004 to about 30 percent in 2010. This is not too high, but could be a problem in some poorer provinces, he said. JP Morgan's Wang suggested that the most senior levels of the Chinese leadership may by motivated by different goals. Premier Wen is most concerned about social stability and protecting his legacy, said Wang, while the next generation of senior leaders does not want to face a serious NPL problem as soon as they take the reins in 2012. She predicted that the People's Bank of China (PBOC) would rely



on its ability to institute micro-level controls on lending to certain regions and sectors to minimize future NPLs.
MARUT